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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. ~~948~~ 24

MARINE HARBOR PROPERTIES, INC.,

Petitioner,

vs.

MANUFACTURERS TRUST COMPANY (successor by merger to The Mortgage Corporation of New York), as trustee for the benefit of certificate holders in mortgage guaranteed by Bond and Mortgage Guarantee Company, Guarantee #181,568,

MAURICE RUBINGER, trustee of Marine Harbor Properties, Inc.,

SAMUEL SILVERMAN, additional trustee of Marine Harbor Properties, Inc.,

MORTIMER RUBENSTEIN, Foreclosure-receiver,

and

SECURITIES AND EXCHANGE COMMISSION.

Brief of Respondent Manufacturers Trust Company, as Trustee, in Opposition to Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

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HAROLD L. SMITH,
Attorney for Manufacturers Trust Company, Trustee.

CURTISS ELY FRANK,
Of Counsel.

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MAURICE RUBINGER, trustee of Marine Harbor Properties, Inc.,

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and

SECURITIES AND EXCHANGE COMMISSION.

Brief of Respondent Manufacturers Trust Company, as Trustee, in Opposition to Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

STATEMENT AND OPINIONS BELOW

Marine Harbor Properties, Inc. (hereinafter referred to as the "debtor") has petitioned this court for the issu-

ance of a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit to review a decision of that court entered January 27, 1942, reversing an order of the United States District Court for the Southern District of New York which denied an application by The Mortgage Corporation of New York, as trustee (merged into Manufacturers Trust Company on September 30, 1941), to dismiss the debtor's petition for reorganization under Chapter X of the Bankruptcy Act and to vacate an *ex parte* order approving the debtor's petition. The opinion of the District Court (Bright, *D. J.*) is reported in 41 F. Supp. 814 (S. D. N. Y.). The majority opinion (Swan, *C. J.* and Chase, *C. J.*) and the dissenting opinion (Frank, *C. J.*) in the Circuit Court of Appeals have not yet been reported.

JURISDICTION

The decree of the Circuit Court of Appeals was entered on January 27, 1942 (R. 126). The petition for a writ of certiorari was filed on February 13, 1942. The jurisdiction of this court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATUTES INVOLVED

Section 141 of Chapter X of the Bankruptcy Act (11 U. S. C., Section 541) provides:

> "§ 541. PETITION OF DEBTOR
>
> Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied."

Section 146 (11 U. S. C., Section 546) provides in part as follows:

"§ 546. Good Faith of Petition

Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if—

* * * * * *

(3) It is unreasonable to expect that a plan of reorganization can be effected; or

(4) A prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.".

STATEMENT OF THE CASE

The majority opinion (R. 106-111) gives a succinct and accurate summary of most of the facts, which will not be here repeated. Two salient facts must, however, be emphasized. First: It is undisputed that the value of the land and apartment house building, which is the debtor's sole asset and which secures the first mortgage (of which Manufacturers Trust Company is trustee for certificate holders), is not more than $350,000, while the amount of such mortgage with arrears of interest and taxes was $399,814.93 on October 1, 1941 (R. 15). Thus, entirely apart from the second, third and fourth mortgages and the balances due on conditional bills of sale, there is a deficit of approximately $50,000. Second: It is also undisputed that under the provisions of the final order of the state Supreme Court approving the appointment of The Mortgage Corporation of New York (now merged into this respondent) as trustee of the mortgage, not only the trustee but also the debtor had

the right to apply to that court for any relief to which it might have felt itself entitled (R. 44). Such final order, entered after court hearing upon notice to the debtor (R. 11) and with its acquiescence and upon the approval of at least 66⅔% in principal amount of certificate holders, provided in part as follows (R. 44):

> "ORDERED that this Court, having assumed jurisdiction of this proceeding, *shall retain jurisdiction hereof until the complete liquidation of the Trust Estate* and the termination of the trust; and the Trustee, or *any other interested party herein, may apply at the foot of this Final Order* upon such notice as the Court may direct *for such other and further relief as to the Court may seem just and proper.*"*

Under the declaration of trust, respondent as trustee is vested with "all the rights and powers of an absolute owner" (R. 24), but these broad powers are limited by Article III of the declaration, which provides (R. 26-27):

> "III. The Trustee shall not extend any bond and mortgage, reduce the rate of interest, release any property from any mortgage except as authorized by the terms thereof or the order above referred to, nor sell the securities or the property covered thereby, without the permission of the Court by order obtained in said reorganization proceeding after ten days' notice by mail addressed to the certificate holders."

The usual procedure is for the property owner to negotiate with the trustee, subject to state court approval, for further extensions and reductions of the mortgage until

*Italics in this brief are supplied unless otherwise noted.

eventually the mortgage can be liquidated or refinanced. So in this case, following the maturity of the mortgage on December 1, 1937, the debtor and the trustee carried on lengthy negotiations looking toward a feasible plan for the further extension and modification of the mortgage (R. 14-15). There was, as is usually the case, a difference of opinion between the debtor and the trustee as to the proper terms for a further extension; but the debtor, instead of availing itself of the privilege of going into the state court which had retained jurisdiction of the matter, with a suggestion for extension of the mortgage, wilfully defaulted in the payment of interest due April 1, 1941 and in the payment of real estate taxes due April 1, 1941. This default occurred at a time when the mortgage was running "open" under the New York Moratorium Laws (New York Civil Practice Act, Sections 1077-a *et seq.*), so that the debtor was simply required to pay taxes and interest at 5% but no amortization, and it occurred despite the fact that the earnings of the property were sufficient to cover taxes and interest (R. 16).

After the trustee's institution of the foreclosure action, the debtor further defaulted with respect to certain promises which it made for the clearing up of arrears and settlement of the foreclosure proceeding (R. 58-59). After the foreclosure action had proceeded for 4½ months with a state court receiver in possession, the debtor obtained an order *ex parte* approving its petition for "reorganization" under Chapter X (R. 13, 6).

THE ISSUE

The issue here is whether or not a mortgagor (debtor), who has no equity in the mortgaged property, and who has

participated in proceedings to reorganize a certificated mortgage in the state court under well established state court procedure and who is entitled to apply to such court in such proceeding for any relief, may ignore the pending state court reorganization and foreclosure proceedings and institute a proceeding in the federal court for "reorganization" under Chapter X.

ARGUMENT

The burden of debtor-petitioner's argument and of the dissenting opinion of the Circuit Court of Appeals is (1) that debtor's filing of a petition in the federal court, despite its utter lack of equity in the property and despite the pendency of the state court proceeding, is not indicative of any lack of good faith, and (2) that even if there was an absence of "good faith" on the part of the debtor the federal court should not dismiss the petition because the Chapter X proceeding might be for the benefit of creditors. Debtor objects to the conclusion of the majority opinion that—"The applicable principle * * * is not an absence of good faith in the filing of the new petition in the broad meaning of those words but a special instance of a lack of good faith flowing from the personal disqualification of the debtor." (R. 111) The basis of the decision of the majority appears, however, in the following two sentences of their opinion (R. 110):

> "But the debtor made no attempt to bring its proposals to the attention of the state court in the pending proceeding, as we think it was entitled to do as an 'interested party'; had it done so its proposals, with the court's approval, could have been presented to the certificate holders. That proceeding provides ade-

> quate means to reorganize the mortgage and protect the rights of all certificate holders whose interests alone exhaust the debtor's property."

It is true that the majority held that the petition should not be dismissed under Section 146, subdivision (3), and they did not hold that it should be dismissed specifically under Section 146, subdivision (4). They concluded that Section 146 does not limit the generality of the meaning of "good faith", which is required by Section 141 to be evidenced to the satisfaction of the court. This would seem to be a correct view, not only because of the express language of Sections 141 and 146, but also because of the general requirements of good faith contained in Sections 142, 143, 144 and in other sections of Chapter X.

We believe that it is immaterial in this case, whether the dismissal is predicated upon "a special instance of a lack of good faith" or upon lack of good faith as defined in subsections (3) or (4) of Section 146. The decisions of the courts show that they have exercised a broad discretion in determining whether or not petitions under Chapter X and its predecessor Section 77B should be dismissed because of lack of "good faith" in their filing.

In *Tennessee Pub. Co.* v. *Amer. Bank*, 299 U. S. 18, this Court, in affirming a dismissal of a petition under Section 77B,* stated (p. 22):

> "Nor do we need to inquire as to the precise limits of the concept of 'good faith' as required by § 77B. * * * However honest in its efforts the debtor may be, and however sincere its motives, the District Court is not bound to clog its docket with

*Section 141 of Chapter X is taken, almost verbatim, from Section 77B.

visionary or impracticable schemes for resuscitation."

In *Securities Comm'n* v. *U. S. Realty Co.*, 310 U. S. 434, this Court, after discussing the requirement of good faith, ruled that a petition filed under Chapter XI should be dismissed, although it fell directly and specifically within the literal provisions of that chapter, solely because the general public interest and purpose of the reorganization statutes required that such a petition should be filed under Chapter X rather than Chapter XI.

In *Chapman Bros. Co.* v. *Security First-Nat. Bank*, 111 F. (2d) 86 (C. C. A. 9), cert. den. 311 U. S. 652, the court affirmed the dismissal of a debtor's petition under Chapter X, on the ground that it lacked good faith. The mortgage on debtor's property exceeded the value of the mortgaged premises by approximately $1,000,000. See also *Seaboard Terminals Corp.* v. *Western Maryland Ry. Co.*, 108 F. (2d) 911 (C. C. A. 4) (where dismissal of petition under Chapter X was affirmed because of doubtful status of debtor's assets and hopelessness of effectuating any reorganization plan which might be submitted); *Wayne United Gas Co.* v. *Owens-Illinois Glass Co.*, 91 F. (2d) 827 (C. C. A. 4), reversed on other grounds 300 U. S. 131; *Reading Hotel Corp.* v. *Protective Committee, etc.*, 89 F. (2d) 53 (C. C. A. 3), cert. den. 302 U. S. 743; *Manati Sugar Co.* v. *Mock*, 75 F. (2d) 284 (C. C. A. 2); *Provident Mut. Life Ins. Co.* v. *University Ev. L. Church*, 90 F. (2d) 992 (C. C. A. 9); *O'Connor* v. *Mills*, 90 F. (2d) 665 (C. C. A. 8); *Price* v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237 (C. C. A. 8), cert. den. 305 U. S. 626; *First Nat. Bank* v. *Conway Road Estates Co.*, 94 F. (2d) 736 (C. C.

A. 8), cert. den. 304 U. S. 578 (where the Circuit Court stated (p. 739): "Whenever want of good faith appears the debtor's petition should be dismissed even though a plan of reorganization has not been submitted.").

In *In re Suburban Properties*, 110 F. (2d) 438 (C. C. A. 7), the court reversed an order approving a debtor's petition under Chapter X, indicating that in view of the debtor's recent incorporation, pendency of a state court foreclosure suit and certain other facts and circumstances, there was an absence of the requisite good faith. Similar results were reached in *In re Williamsport Wire Rope Co.*, 10 F. Supp. 481, appeal dismissed 78 F. (2d) 1023 (C. C. A. 3) (petition under Section 77B dismissed for lack of good faith where plan did not appear feasible and continuation of existing equity receivership appeared more practical); *In re Philadelphia Rapid Transit Co.*, 8 F. Supp. 51, aff'd 73 F. (2d) 1022 (C. C. A. 3) (petition under Section 77B dismissed although literally within its terms, on the ground that good faith was lacking because petitioner's securities were acquired simply as means to institute the proceeding); *In re North Kenmore Bldg. Corporation*, 81 F. (2d) 656 (C. C. A. 7) (petition under 77B dismissed as not filed in good faith where debtor was incorporated in order to institute proceeding, had no equity in property and bondholders opposed); *In re Wisun & Golub, Inc.*, 84 F. (2d) 1 (C. C. A. 2). Cf. *In re Julius Roehrs Co.*, 115 F. (2d) 723 (C. C. A. 3).

Those judges of the Circuit Court of Appeals who have sat in the Second Circuit for the past nine years, are familiar with the proceedings which have been successfully conducted under the Schackno Act (Chapter 745 of the New York Laws of 1933, as amended) and under the Mort-

gage Commission Act (Chapter 19 of the New York Laws of 1935). When the guaranty mortgage companies defaulted on their guarantees early in 1933, there were approximately $700,000,000 of certificated mortgages outstanding. Immediately the Insurance Department, and subsequently the Mortgage Commission, was empowered under the above mentioned statutes to supervise the reorganization of these mortgages.* From the start and continuously during the past nine years the Second Circuit Court of Appeals has rejected efforts of various minority groups with doubtful motives to bring the administration of these mortgages into the federal courts. *Jacoby* v. *Bond & Mortgage Guarantee Co.*, 72 F. (2d) 420, cert. den. 293 U. S. 619; *Telfree* v. *New York Title & Mortgage Co.*, 72 F. (2d) 702, cert. den. 293 U. S. 619; *Depen* v. *Lawyers' Title & Guaranty Company*, 72 F. (2d) 705, cert. den. 293 U. S. 619; *Brooklyn Trust Co.* v. *Rembaugh*, 110 F. (2d) 838; *In re Blinrig Realty Corporation*, 114 F. (2d) 100; *In re Paloma Estates, Inc.*, decided February 21, 1942 (Judges Learned Hand, Chase and Clark) unreported. See also *In re Coney Island Hotel Corporation*, 76 F. (2d) 126; *In re Francfair, Inc.*, 13 F. Supp. 513 (S. D. N. Y.); *In re Reliable Estates*, 33 F. Supp. 588 (E. D. N. Y.). Cf. *Pennsylvania* v. *Williams*, 294 U. S. 176.

In *Brooklyn Trust Co.* v. *Rembaugh*, *In re Blinrig Realty Corporation* and *In re Paloma Estates, Inc.*, the court ordered dismissal of petitions under Chapter X be-

*For a history of the $700,000,000 of certificated mortgages so reorganized and placed under permanent trusteeships, see the report of the Mortgage Commission to His Excellency, the Honorable Herbert H. Lehman, Governor of the State of New York, and to the Legislature of the State of New York, dated April 1, 1939 (Legislative Document No. 94).

cause of pending Schackno reorganizations in the state court.

The record in the instant case is not appropriate to a determination, such as is apparently sought by the Securities and Exchange Commission, as to whether or not the jurisdiction of the state courts in all Schackno Act mortgage reorganizations should be ousted at the request of mortgagors and further "reorganization" of these mortgages maintained in the United States District Court for the Southern District of New York under Chapter X of the Bankruptcy Act. The Securities and Exchange Commission did not intervene until after the decision of the District Court, and when the case was in the District Court it was not known that efforts would be made to make it a test for determining the general question of jurisdiction between state and federal courts with respect to "Schackno mortgages". Therefore, some of the facts hereinafter set forth do not appear in the record. They are, however, matters of common knowledge to those engaged in the mortgage business in New York City, many of them appear in the reports of the Mortgage Commission to the Governor and the Legislature and in the annual reports of the Superintendent of Insurance to the Governor and the Legislature, and it has been deemed advisable that this Court, to assist it in determining whether or not certiorari should be granted in this case, should have such facts made available to it.

It is our information that in no state, except New York, and in almost no city, except New York City, were there companies which guaranteed certificated mortgages. It is our information that the reorganization of these guaranteed certificated mortgages is a problem which exists in New York State alone and largely in New York City alone. It

would seem to us therefore that there is no good reason why this court should be asked to review the decision of the Circuit Court of Appeals in this case. There is not, and in the nature of things there could not be, a conflict of circuits. The only question of federal law decided has been the procedure to be followed with respect to a problem peculiarly local and covered by a special set of state statutes.

The Second Circuit Court of Appeals has been aware of the fact that special terms have been created in the state courts and justices assigned to such terms whose chief function is the handling of these guaranteed certificated mortgages (R. 18-19; Chapter 19, New York Laws of 1935, Section 17a; Section 1768 of Unconsolidated Laws). It has also been aware of the fact that recently, by Chapter 704 of the Laws of 1940, amending Section 17a of Chapter 19 of the New York Laws of 1935 (The Mortgage Commission Act), the New York State Legislature has added still another cog to the comprehensive machinery of state court certificated mortgage reorganizations through the creation of an agency designated by the order of the Supreme Court, Kings County, as the Bureau of Trust Supervision. This bureau fulfills the functions formerly fulfilled by the Mortgage Commission, which has now gone out of existence. All applications for the further readjustment of certificated mortgages, where the property is located in the Second Judicial Department (as is this property), must be on notice to this bureau. It is the duty of this bureau to analyze each proposed plan of extension or liquidation, to appear in court and, with the benefit of the wide certificated mortgage reorganization experience which its personnel (who were formerly with the Mortgage Commission) have accumu-

lated over a period of years, to advise the court as to the fairness of the plan. It is the duty of the trustee to account annually to certificate holders and to the court (R. 27-28), and each such annual accounting is subject to the careful scrutiny of this bureau. Judge Frank, in his dissenting opinion (R. 118) emphasized the role played by the Securities and Exchange Commission in Chapter X proceedings, but it is respectfully submitted that the specialized experience which the Bureau of Trust Supervision has in dealing with certificated mortgages qualifies it to advise wisely in these matters far more than does the experience of the Securities and Exchange Commission, whose activities largely concern ordinary stocks and bonds.

Almost all of the certificated mortgages have been extended and modified and a trustee named under a standard declaration of trust similar to that appearing in this record. In the Second Judicial Department the services of leading trust companies in New York City have been enlisted and such companies uniformly have been named as trustees by the Kings County Supreme Court. Most of these certificated mortgages, formerly guaranteed by mortgage guaranty companies, were, like the instant mortgage, made in the late nineteen twenties or very early nineteen thirties and, as a result, most of them are today top-heavy, so that the property owners have no equity in the property. Most of the owners are "dummy" corporations, with no other asset than the mortgaged property, formed simply to avoid personal obligation on the mortgage bond. If each time one of these mortgages matures and the owner is unable to obtain the terms which it desires it is to be permitted to come into the federal court under the guise of a "reorganization" proceeding, it will be almost impossible successfully to consum-

mate the comprehensive scheme of economical and orderly liquidation created by and progressing under the state statutes.

Under the state court procedure property owners are required to pay the costs of mortgage extensions, which are small. If there is to be a Chapter X proceeding, the estate, which in reality is the mortgage certificates, must pay the trustee's fees, trustee's counsel fees, mortgage trustee's fees and fees of its counsel, possibly committee fees and expenses, possibly special master's fees, fees of debtor's attorneys, and the other expenses attendant upon a so-called "reorganization". (See Subchapter XIII of Chapter X; U. S. C., Sections 241, 242, 243).

The dissenting opinion (R. 113) suggests that a mortgage trustee appointed by a state court may have a selfish interest in continuing the state court proceeding, to wit: its fees. The standard declaration of trust limits its fees to one-twelfth of income distributed to certificate holders, not to exceed one-third of one percent per annum of principal. Its counsel ordinarily receive no fees from the trust (R. 29, 30). Moreover, upon default by a property owner, the standard practice is for the trustee immediately to institute foreclosure proceedings, convert the mortgage into real estate, sell the real estate and liquidate the trust upon notice to certificate holders and with court approval as soon as a good offer for the property is received. That is what the trustee is seeking to do here. Of course, upon liquidation, the fees of the trustee cease altogether.

It has been argued that perhaps some good to creditors —that is certificate holders—can result from a petition which has been filed by a debtor with no equity and which apparently is desired by no one other than the debtor. But

certificate holders have consented to the state court trusteeship by overwhelming vote. They have selected the trustee in their approval of the Schackno plan. Why should they be made to bear the expense of an attempted fictitious "reorganization" of a debtor who has no interest in the property? No one seriously expects the debtor to put in new money, since there is a deficit of $50,000 on the first mortgage alone, not to mention subordinate mortgages and conditional bills of sale.

It is said that perhaps a new corporation can be created to take over the property (R. 114). To organize a corporation and pay corporation taxes would be fruitless and far more expensive than the present trusteeship. The problem of converting numerous certificate holders into stockholders and enabling them to select directors who could and would operate the property honestly, expertly and efficiently is a difficult one. The so-called corporate method of "reorganizing" these certificated mortgages was tried in 1934, in the early days of the Shackno Act, and was rejected both by the certificate holders themselves and by the state courts as utterly unworkable and uneconomical. If certificate holders must terminate the mortgage because of the debtor's wilful default, what method is simpler and cheaper than to have the trustee conclude the foreclosure proceeding which has already proceeded for four and one-half months in the state court?

There has been a suggestion (dissenting opinion R. 123-124) that state court proceedings have sometimes been resorted to in order to avoid Chapter X proceedings. That claim, however, cannot be substantiated in the present situation where the New York State Legislature, Insurance Department, Mortgage Commission and courts have success-

fully and economically handled the entire certificated mortgage problem for almost nine years (Report of Mortgage Commission, *supra*, p. 10, n.

The danger which the trustee appointed by the state court faces in cases such a this is the possibility that the debtor, by consciously depreciating the value of certificates, will discourage certificate holders and cause them to sell their certificates in the over-the-counter market in New York City for far less than they are worth. In this way, a debtor may easily through brokers acquire most or all of the certificates, and thus the ownership of the mortgage itself, for far less than either its face or true value. In the instant case, that may well occur unless this proceeding is brought to a speedy halt. The debtor's wilful default in taxes and interest, although earnings of the property were then sufficient to cover such items (R. 16, 10), cut off the income of certificate holders. The necessary foreclosure proceeding, which followed has meant further delay in receipt by them of any income.* The debtor's president has stated in her affidavit that the price of the certificates in the open market on September 29, 1941 had dropped to 50% of "par" (R. 63). Unless the instant petition is denied there will be further expense, delay and absence of income to certificate holders with consequent further depreciation in the market value of certificates, all of which may well permit the debtor to benefit at the expense of needy certificate holders.

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*Although a stipulation was recently signed, after hearing in the Circuit Court of Appeals, permitting the receiver to make repairs and pay taxes and interest, the receiver has asserted that under present circumstances, because of tax arrears, necessary repairs and the necessity of reserves to cover foreclosure expenses, he can make no interest payments.

CONCLUSION

It is respectfully submitted that the debtor-petitioner has shown no reason in law or in fact which would justify this Court in granting its petition for certiorari in this case and that therefore the petition should be dismissed.

Respectfully submitted,

HAROLD L. SMITH,
Attorney for Manufacturers Trust Company, Trustee.

CURTISS ELY FRANK,
Of Counsel.